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**Hearing Statement of Senator Max Baucus (D-Mont.)
Regarding International Tax Reform**

The Italian Renaissance historian Francesco Guicciardini said: “Industries . . . are at their best before . . . people recognize how profitable they are. As soon as that happens, they decline, for strong competition makes them less profitable. Thus, in all matters, it is wise to get up very early.”

Today we will discuss international tax competition. We’ll try to assess whether we’re at our best — or whether strong competition is making us less profitable. Either way, we may find it wise to get to tax reform very early.

Tax competition happens when countries compete with each other about how much they tax multinational businesses.

To understand this competition, we need to explore how America taxes the foreign income of U.S.-based multinational businesses now. And we need to explore the various ways that America could tax that income in the future.

At the extremes, there are two ways to tax the foreign income of these businesses.

The first is to tax all of the activities of the business, no matter where they take place. This is called “worldwide taxation.” A worldwide system avoids double taxation by allowing a business to take a credit against U.S. taxes in the amount of foreign taxes paid overseas.

The second way to tax multinational businesses is for a country to tax only income derived within its borders. This is called “territorial taxation.” In a territorial tax system, the country taxes this income whether the taxpayer is a resident or not.

In a territorial system, any entity earning income in the resident country will owe tax on that income. And if the entity earns income outside of the resident country, then the entity won’t owe tax.

Our system is somewhere in between. America’s system is partly worldwide, and partly territorial.

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In 1962, Congress enacted Subpart F of the Internal Revenue Code. Subpart F applies when an American entity runs an active business in a foreign country. Subpart F allows the entity to defer paying tax on the foreign income until it repatriates the foreign income back to America.

Subpart F generally does not allow deferral, however, for passive income. Passive income includes rents, royalties, and interest. This income is mobile. With the aid of the Internet, it can move quickly from one country to another.

Critics of Subpart F argue that much has changed since 1962. In 1962, America was a net exporter of capital. Now, we are a net importer of capital.

In 1962, manufacturing dominated America's economy. Now, our economy is quite diverse. Intellectual property is our most important export.

After 46 years, it's time to consider whether Subpart F still functions properly. It's time to consider whether we need to make minor tune-ups to Subpart F, or start anew.

Congress and the new President will need to work together to ensure that the Internal Revenue Code will collect the revenue that we'll need. And at the same time, we'll need to ensure that American businesses are able to compete in the global economy.

Other countries are also considering changing how they tax foreign income. The United Kingdom and Japan are looking to modified territorial tax systems. The European Union may consider changes for business activities within the EU. We need to keep this competition in mind.

American businesses are competing for capital and jobs. Let's try to be at our best. Let's ensure that strong competition does not make us less profitable. And let us act wisely, and get to tax reform very early.

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